Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Mobility Fund	)	WT Docket No. 10-208
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	

Comments of
Cellular South, Inc.
NE Colorado Cellular, Inc. d/b/a Viaero Wireless
Rural Cellular Association
Westlink Communications, LLC

I. Introduction

These Comments concern the use of auctions to distribute support from the high-cost universal service fund ("USF" or "Fund"). Sections 214 and 254 of the Telecommunications Act of 1996 (the "Act") require a Fund that helps all consumers to access voice services and pay rates that are reasonably comparable to those available in urban areas.[1] The Federal Communications Commission ("FCC" or "Commission") implements § 214 and § 254 through a combination of price-cap regulation and rate-of-return regulation, as well as the designation of competitive eligible telecommunications carriers (each, an "ETC").[2] Going forward, however, the Commission may distribute high-cost support through reverse auctions, as recommended by

[1] *See, e.g.*, 47 U.S.C. §§ 214, 254 (2010).
[2] FEDERAL COMMUNICATIONS COMMISSION, NATIONAL BROADBAND PLAN 141 box 8-2 (2009).

71 economists in a recent filing to the Rural Utilities Service and the National Telecommunications and Information Administration.[3]

We appreciate and understand that 71 economists favor the use of support auctions to promote broadband deployment. But as noted by Paul Krugman, the Nobel-prize winning economist, economists don't always have the right idea, especially when government programs are involved.[4] With respect to federal programs in particular, we are reminded of the following words of Ronald Coase:

> If a federal program were established to give financial assistance to Boy Scouts to enable them to help old ladies cross busy intersections, we could be sure that not all the money would go to Boy Scouts, that some of those they helped would be neither old nor ladies, that part of the program would be devoted to preventing old ladies from crossing busy intersections, and that many of them would be killed because they would now cross at places where, unsupervised, they were at least permitted to cross.

For a number of reasons more fully explained below, the auctions supported by the 71 economists are not the "right idea" for USF.

The use of support auctions to distribute high-cost USF would ignore two earlier rejections of the concept while also undermining competition.[5] In the *First USF Report and*

[3] Paul Milgrom, et al., Comments of 71 Concerned Economists: Using Procurement Auctions to Allocate Broadband Stimulus Grants (Apr. 13, 2009).
[4] *See* Paul Krugman, *How Did Economists Get it So Wrong?*, NY TIMES, Sept. 6, 2009, at MM36.
[5] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report & Order, 12 FCC Rcd. 8776, 8950 (1997), *aff'd*, 183 F.3d at 411 [hereinafter *First USF Report and Order*]; *High-Cost Universal Service Support*, WC Docket No. 05-337, Notice of Proposed Rulemaking, 23 FCC Rcd. 1495, 1500 ¶ 11 (2008)[hereinafter *Reverse Auctions Notice*]. *See also* Paul Milgrom, *Procuring Universal Service: Putting Auction Theory to Work*, Lecture at the Royal Swedish Academy (Dec. 9, 1996); Dennis Weller, *Auctions for Universal Service Obligations*, 23

Order, the FCC declined to adopt reverse auctions in part because of a lack of competition in high-cost areas.[6] The 2008 *Core Remand Order* likewise repudiated support auctions, albeit without comment, after suggesting in the notice of proposed rulemaking that the concept could "offer several potential advantages over current high-cost support distribution mechanisms."[7] Despite these previous rejections of support auction mechanisms, the Commission is yet again examining support auctions and revisiting the same issues highlighted in earlier proceedings.[8]

The *CAF Notice* and the *Mobility Fund NPRM* both involve support auctions. The *CAF Notice* asks whether support auctions would efficiently extend broadband infrastructure to unserved areas and requests comment on auction scoring.[9] The *Mobility Fund NPRM*, by contrast, proceeds directly to inquiries regarding:

- Bidder eligibility;[10]
- Service standards and compliance;[11]
- The legal authority of the Commission to conduct the auctions;[12]
- Single-winner and single-round reverse auctions;[13]
- Identifying unserved areas; and [14]

TELECOMM. POL'Y 645 (1999); Comments of the Nat'l Ass'n of State Utility Consumer Advocates, filed in *High-Cost Universal Service Support*, WC Docket No. 05-337, 4-7 (Apr. 17, 2008) (detailing the history of reverse auction proposals brought before the Commission prior to 2008*)*.

[6] *First USF Report and Order*, 12 FCC Rcd. at 8950.

[7] *Compare Reverse Auctions Notice*, 23 FCC Rcd. at 1500 ¶ 11; *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, Order on Remand & Report & Order & Further Notice of Proposed Rulemaking, 24 FCC Rcd. 6475, 6492 ¶ 37 (2008) [hereinafter *Core Remand Order*].

[8] *Cf. Core Remand Order*, 24 FCC Rcd. at 6515-6522*; Connect America Fund*, WC Docket No. 10-90, Notice of Inquiry & Notice of Proposed Rulemaking, 25 FCC Rcd. 6657, 6675 ¶ 45 (2010)[hereinafter *CAF Notice*]; *First USF Report and Order*, 12 FCC Rcd. 8776, 8950-8951.

[9] *CAF Notice*, 25 FCC at 6675-6676 ¶ 47.

[10] *Mobility Fund NPRM* at ¶ 5.

[11] *Id.* at ¶¶ 5, 34.

[12] *Id.* at ¶ 12.

[13] *See id.* at ¶¶ 15, 17.

[14] *Id.* at ¶¶ 21,23.

- Alternative distribution mechanisms.[15]

Support auctions raise the same issues in both proceedings: identifying appropriate geographic areas,[16] technological neutrality, winner-take-all v. winner-take-more, carrier of last resort obligations, enforcement, subsidy length or term, and service quality.[17] These Comments explain why, in the real-world context of USF, the Commission should reach the same conclusion it has reached twice before: support auctions simply do not make sense as a distribution model for USF.

II. Conditions in the Broadband "Market" Prevent the Use of Reverse Auctions

In reverse auctions, a single buyer invites pre-qualified sellers to compete against each another to sell a given good or service.[18] Reverse auction formats vary in terms of the number of bidders, the number of bidding rounds, whether competitors can see each other's bids, and the criteria used to select the winning bidder.[19] But the overall goals are usually as follows: increased savings, increased transparency, and reduced process times relative to other purchasing methods.[20] In practical effect, reduced prices are usually prioritized above transparency and lead time by the procuring agency.[21] The procuring agency in this instance, the Commission, hopes

[15] *Id.* at ¶ 5.
[16] Notably, § 214 requires designated ETCs to provide service throughout a "service area" defined by a State commission. Whether the Commission can unilaterally distribute high-cost support to specific census blocks remains an open question.
[17] James Stegeman, et al., *Controlling Universal Service Funding and Promoting Competition through Reverse Auctions* 14-31 (2007), attached to CTIA-The Wireless Association Reply Comments, WC Docket No. 05-337 (filed Nov. 8, 2006) [hereinafter *CostQuest Auction Paper*].
[18] Kitsada Dolpanya, et al., *A Conceptual Framework for Investigating Suppliers' Participation in Business-to-Government (B2G) Electronic Auction Markets in the Thai Context* 4 (AMCIS Proceedings Paper No. 678, 2009), http://aisel.aisnet.org/amcis2009/678.
[19] *Id.*
[20] Ernan Haruvy & Sandy Jap, *Competitive Bidding Strategy in Buyer-Determined Online Reverse Auctions* 2 (June 2008)(manuscript on file with NE Colorado Cellular, Inc.); G. Giampietro & M.L. Emiliani, *Coercion and Reverse Auctions*, 12 SUPPLY CHAIN MNGT. 75 (2007).
[21] Dolpanya, *supra* note 18, at 4; *see* Ohad Soudry, *Promoting Economy: Electronic Reverse Auctions under the EC Directives on Public Procurement*, 4 J. PUB. PROCUREMENT 340, 342 (2004).

to "reduce prices" through the actions outlined in the *CAF Notice* and the *Mobility Fund NPRM*, which are designed to limit growth in the Fund.[22] But if policymakers hope to control the size of the Fund over time, reverse auctions are not the preferred approach.[23]

Reverse auctions will often yield immediate gains when a single buyer wants to save money on a commodity sold by a large number of similarly-situated sellers and both sides have access to similar information regarding the product.[24] But reverse auctions are inappropriate if (a) a public procurement involves only a few asymmetric bidders selling a specialized service, (b) the sellers know more about those services than the buyer, and (c) the buyer wants to save money over a long period of time.[25] We consider each aspect of reverse auctions in more detail below.

A. Insufficient Number of Bidders

The success of an auction is driven by the number of competing bidders.[26] With a reverse auction, more sellers help the buyer to save more.[27] Conversely, the ultimate price paid

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[22] *CAF Notice*, 25 FCC Rcd. at 6658.

[23] *See* Reply Comments of the Nat'l Assoc. of State Util. Consumer Advocates on the Use of Auctions to Determine High-Cost Universal Service Support filed in High-Cost Universal Service Support, (WC Dkt. No. 05-337) (Nov. 8, 2006).

[24] Kevin Werbach, *Connections: Beyond Universal Service in the Digital Age*, 7 J. ON TELECOMM. & HIGH TECH. L. 67, 80 (2009); David Kestenbaum, *Morning Edition: Complicated Reverse Auction May Aid in Bailout*, (National Public Radio radio broadcast, Oct. 10, 2008) (interview with Dr. Peter Cramton and Dr. Larry Ausubel), http://www.npr.org/templates/story/story.php?storyId=95591129. The Western States Contracting Alliance, for example, uses reverse auctions to purchase items like office supplies and baby formula. WSCA: Western States Contracting Alliance, WSCA Frequently Asked Questions, http://www.aboutwsca.org/content.cfm/id/WSCA_Vendor_FAQs (last visited Nov. 18, 2010).

[25] *See, e.g.*, 24 CFR § 85.36 (d)(2); Susan Combs, Texas Comptroller, *State Purchasing Reverse Auction Information* ("Not all commodity types are a good fit for reverse auctions….[The State of Texas] analyzes the number of bidders in previous similar solicitations; the competitive volume; the effectiveness of prior reverse auctions for the same or a similar commodity; the number of potential suppliers registered on the Centralized Master Bidders List (CMBL); the number of delivery locations; and other factors that may be specific to a particular commodity."), http://www.window.state.tx.us/procurement/reverse_auction_info.html (last visited Oct. 5, 2010).

[26] Irene S. Wu, Federal Communications Commission, *Maximum Impact for Minimum Subsidy: Reverse Auctions for Universal Access in Chile and India* 4 (FCC Staff Working Paper No. 2, Oct. 2010), *available at* http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db1029/DOC-302511A1.pdf; Patrick Bajari, et al., *Auctions Versus Negotiations in Procurement: An Empirical Analysis*, 25 J. L. ECON. & ORG. 372, 374 (2009); *CostQuest Auction Paper* supra note 17, at 11.

[27] Bajari, *supra* note 26, at 380.

by the buyer is always higher when the number of bidders is small, but especially when the auction involves a single-round, sealed bid[28] format.[29] With respect to high-cost support, both the CAF and the Mobility Fund would involve a small number of bidders, given that most homes and small businesses in the United States can only receive a broadband connection from a single telephone company or a single cable company.[30] While the Commission can provide the appearance of greater competition by making the auction nationwide, as it has proposed in the *Mobility Fund NPRM*,[31] such an approach will ignore the fact that broadband competition is decidedly local in nature.[32]

In rural areas where high cost support is needed the most, some people lack access to even a single broadband provider, let alone two, and small businesses pay comparably more per megabit.[33] By auctioning high-cost support, the Commission would face the same dilemma as the average consumer: a lack of choice in providers, prices, or speed.[34] Moreover, the proposed

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[28] *See Mobility Fund NPRM* at ¶ 75.

[29] *See* Haruvy & Jap, *supra* note 20, at 24 (describing the results of a multi-round, descending auction with non-price winning criteria).

[30] Commission Open Meeting Presentation on the Status of the Commission's Processes for Development of a National Broadband Plan, at 135 (Sept. 29, 2009), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-293742A1.pdf; Cramton, *infra* note 37, at 7; SMALL BUSINESS ADMINISTRATION, THE IMPACT OF BROADBAND SPEED AND PRICE ON SMALL BUSINESS 18 (Nov. 2010) [hereinafter SBA REPORT], http://www.sba.gov/advo/research/rs373tot.pdf. Efforts to increase competition through a wireless "third pipe" have been limited by the aforementioned concentration in the wireless market and by the fact that the two largest vertically-integrated wireless providers are also DSL providers. *See* Cramton, *infra* note 37, at 9; *Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Services*, Fourteenth Report, at 43 ¶ 20 (2010) [hereinafter *14th CMRS Report*].

[31] *See Mobility Fund NPRM* at ¶ 67 (proposing to permit bidders to submit package bids).

[32] SBA REPORT, *supra* note 30, at 23; *Ex Parte* Submission of the United States Department of Justice, *in* Economic Issues in Broadband Competition, GN Docket No. 09-51, at 12 (filed Jan. 1, 2010) ("Broadband markets are local in nature as customers can choose only among providers that serve their neighborhoods, and the providers and service offerings differ from one area to another.") [hereinafter *DOJ Filing*].

[33] JONATHAN E. NEUCHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS 156 (2005); SBA REPORT, *supra* note 30, at 61 ("Competition must be measured from the consumer's perspective—that is, the alternatives available to an individual consumer at a given location."); ECONOMICS AND STATISTICS ADMINISTRATION & NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION, EXPLORING THE DIGITAL NATION: HOME BROADBAND INTERNET ADOPTION IN THE UNITED STATES 24 (Nov. 2010) [hereinafter NTIA RESIDENTIAL BROADBAND REPORT].

[34] Rob Frieden, *Lies, Damn Lies and Statistics*, 14 VIRGINIA J. ON L. & TECH. 100, 104 (2009) ("The paper concludes that the absence of robust price competition among facilities-based broadband operators in many areas of

Mobility Fund would involve a single-round sealed auction with a small number of bidders, a format that does not often yield the desired savings.[35] Given that consumers in high-cost areas face such a lack of choice, it simply does not make sense for the Commission to distribute support through an auction mechanism, especially a single-round, sealed bid reverse auction.

B. The Available Bidders are Asymmetric

Even when enough bidders compete in a reverse auction, the market power of certain suppliers can produce undesirable post-auction results.[36] Inefficiencies arise in post-auction markets because dominant, deep-pocketed carriers can and will bid against smaller competitors in a predatory fashion.[37]

> Intuitively, the reason is that in a sealed-bid auction a strong bidder faces less competition than a weak bidder. The strong bidder faces the field minus itself, while the weak bidder faces a field that includes the strong bidder. Thus a strong bidder will seek a higher profit, while a weak bidder, facing stronger competition, will bid closer to actual value."[38]

That is, smaller bidders with less capital are more vulnerable to market fluctuations and intimidation than larger bidders with more money and better access to capital.[39] This is particularly true in telecommunications markets, where dominant incumbents can deploy services at a lower incremental cost than smaller competitors due to their existing plant, scale,

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the nation challenges several of the assumptions built into recent FCC policy initiatives that seek to abandon consumer safeguards."); SBA REPORT, *supra* note 30, at 2.

[35] *See* Rob Frieden, *Case Studies in Abandoned Empiricism and the Lack of Peer Review at the Federal Communications Commission*, 8 J. ON TELECOMM. & HIGH TECH. L. 277, 286 (2009); Soudry, *supra* note 21, at 356.

[36] P. Preston McAfee et al., *The Greatest Auction in History, in* BETTER LIVING THROUGH ECONOMICS 173 (2008)

[37] Peter Cramton, et al., *The 700 MHz Spectrum Auction: An Opportunity to Protect Competition in a Consolidating Industry* (Nov. 13, 2007), *available at* http://is.gd/gUCXS [hereinafter *700 MHz Consolidation*].

[38] McAffee, *supra* note 36, at 173.

[39] Gregory F. Rose & Mark Lloyd, Center for American Progress, The Failure of FCC Spectrum Auctions 11 (May 2006).

and—in some instances—low-frequency spectrum holdings.[40] What's more, competition regulators expect that prices in telecommunications markets will not even reflect incremental costs.[41] In short, anti-competitive post-auction markets can arise because dominant carriers value gaining or maintaining a monopoly in an area more highly than their ability to profit from providing service in the area. In other words, dominant carriers have an enormous incentive to use the bidding process to drive support levels below cost and thus push out the smaller carriers who have traditionally served rural America.

As shown by support auctions in Australia, Chile, and India, incumbents have gone so far as to actually bid support amounts below zero in an effort to eliminate their competitors.[42] The Indian carrier BNSL, for example, has repeatedly bid down support amounts below zero in less competitive auctions, leading potential competitors to avoid entering the market.[43] Likewise, Chilean support auctions led incumbents to submit zero-amount bids in competitive areas to protect their monopoly, as more fully described below.

Beyond the USF context, business-to-business procurements have likewise forced competitors out of business and led to industry consolidation.[44] If international experiences are any guide, and if the Commission does not prevent dominant incumbents from bidding below

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[40] Peter Cramton, *700 MHz Device Flexibility Promotes Competition* 5 (Aug. 9, 2010), http://www.cramton.umd.edu/papers2010-2014/cramton-700-mhz-device-flexibility-promotes-competition.pdf; *see also* Trevor R. Roycroft, *Reverse Auctions for Universal Service Funding?* 23 (Feb. 1, 2008) (noting that support auctions held in South America involved a "green field" build for pay phone deployments, but that support auctions in the United States would involve extending or replacing existing plant.), http://www.roycroftconsulting.org/Roycroft_Consulting_Auction_White_Paper_2-1-08.pdf.

[41] *DOJ Filing* at 7.

[42] *See* Scott Wallsten, *Reverse Auctions and Universal Telecommunications Service*, 61 FED. COMM. L.J. 373, 375-384 (2008) (describing auctions in Australia, China, and India).

[43] Wu, *supra* note 26, at 14 tbl. 5.

[44] Sandy Jap, *Going, Going, Gone*, HARV. BUS. REV., Nov. 1, 2000, at 3, *available at* http://www.bus.emory.edu/sdjap/docs/GoingGoingGone.pdf.

cost,[45] then the proposed support auctions will likewise limit competition in the United States and cause further market consolidation.[46] That is, reverse auctions will promote consumer harm.[47]

C. Ensuing Market Concentration will Undermine Efforts to Control Fund Growth

Support auction advocates naturally focus on the immediate savings gained at the auction block and not the costs incurred in implementation.[48] But even without predatory bidding, reverse auctions still fail to achieve the expected savings once time and quality are factored into the calculation.[49] With respect to quality, for example, if the buyer includes quality as a purchasing criterion, then high-quality suppliers do not bid aggressively against low-quality suppliers, and the buyer saves little.[50] But if quality is not included as a purchasing criterion, then some auction bidders may bid lower than others and distort the support available to higher-quality suppliers.[51] As for time, as indicated above, auction-facilitated consolidation causes bargaining power to shift to the remaining suppliers and those remaining suppliers then seek to maximize profits through post-auction modifications to goods or services that are intended to

[45] Soudry, *supra* note 21, at 360 (noting that, "when tenderers are asymmetric, such as in cases of heterogeneous tenderers, …a contracting authority is able to yield efficient allocation of resources if it conducts either a second-price or English auction.").
[46] *Compare* Peter Cramton, *Spectrum Auctions, in* HANDBOOK OF TELECOMMUNICATIONS ECONOMICS (Cave et. al. eds. 2002), *with* Soudry, *supra* note 21, at 356 (arguing that contracting authorities should have the authority to "set aside as abnormally low those tends offering a discount greater than what seems reasonable.").
[47] *See* Wallsten, *supra* note 42, at 382 ("As Australia's experience shows…introducing competition and reducing subsidies are not necessarily consistent, at least in the short run"); *DOJ Filing* at 15 ("[I]n highly concentrated markets consumers can be significantly harmed when the number of strong competitors declines from four to three, or three to two.").
[48] M.L. Emiliani, *Executive Decision-Making Traps and B2B Online Reverse Auctions*, 11 SUPPLY CHAIN MNGT. 6, 7 tbl. 1 (2006) . *See also* Dale Lehman, *Reverse Auctions Panel Presentation to the Joint Board on Universal Service* (Feb. 20, 2007).
[49] Giampietro & Emiliani, *supra* note 20, at 75.
[50] Haruvy & Jap, *supra* note 20, at 2..
[51] Lehman, *supra* note 48, at 3.

improve margins, but that ultimately raise costs for the purchaser in subsequent competitions.[52] In other words, rising prices and reductions in quality become almost inevitable in a less competitive market.[53]

When asymmetric bidders and networked industries are factored in, the problem becomes even more pronounced: in Chile, for example, telecommunications incumbents bid zero for areas where they faced competition. Competitors were thus induced to leave the market, which led the incumbent to turn around and bid the maximum subsidy amount in subsequent rounds.[54] As a result, the Chilean government found itself left with fewer suppliers than when it began and Chilean consumers ultimately paid more for telecommunications because of government-facilitated consolidation.[55] A similar intervention in Australia did not promote competition and failed to produce new economic value to offset resulting shareholder losses.[56]

D. Differentiated Services with Non-Quantifiable Elements are not Amenable to Procurement through Reverse Auctions

Even if many suppliers are available to compete in a reverse auction, some goods are simply not suitable for procurement through that mechanism.[57] In general, commodity products and services are easier to auction because price is the key purchasing criteria and price is

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[52] Jap, *supra* note 44, at 3; Peter Cramton, *Competitive Bidding Behavior in Uniform-Price Auction Markets* 2 (Mar. 30, 2003), *filed in* San Diego Gas & Elec. Comp. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operators Corporation and the California Power Exchange, et al., before the United States Federal Energy Regulatory Commission, Docket. No. EL00-95-075, [hereinafter *Cramton FERC Filing*], *available at* http://www.cramton.umd.edu/papers2000-2004/cramton-bidding-behavior-in-electricity-markets.pdf; Emiliani, *supra* 48, at 6.

[53] Tobias Schoenherr & Vincent A. Mabert, *Online Reverse Auctions: Common Myths Versus Evolving Reality*, 50 BUS. HORIZONS 373, 383 (2007)

[54] Björn Wellenius, *Closing the Gap in Access to Rural Telecommunications: Chile 1995-2002* 17-18 (World Bank Discussion Paper No. 430, Feb. 2002), *available at* http://rru.worldbank.org/Documents/Paperslinks/1222.pdf.

[55] Wallsten, *supra* note 42, at 384 (noting that competition in Chilean auctions decreased and prices increased between 1995-2000 as auctions led to increased industry consolidation).

[56] David Kennedy, *Universal Service Reform in New Zealand—Ovum Comment*, VOXY.CO.NZ (Mar. 24, 2010), http://www.voxy.co.nz/business/universal-service-reform-new-zealand-ovum-comment/5/42786; Wallsten, *supra* note 42, at 382.

[57] Daesik Hur, et al., *Getting the Most out of Reverse E-Auction Investment*, 35 OMEGA 403, 407 (2007).

quantifiable.[58] But when a buyer tries to purchase complex or differentiated services with non-quantifiable elements, the auctions are considerably more difficult to design, the auctions usually don't yield the expected savings, and some sellers may simply choose not to participate.[59] (The Pentagon, for example, routinely fails to save money through reverse auctions for Patriot missiles but enjoys substantial savings when buying laptop computers.)[60] "Consequently, many contracts, such as those that have intellectual performance as their subject matter or design of works," are usually not procured through reverse auctions.[61] We therefore question why the Commission would, in both the CAF and the Mobility Fund, seek to lump together differentiated broadband services that are not substitutes for one another.[62] After all,

> Broadband services differ along a number of dimensions: the speed actually delivered, the reliability of the underlying network, and whether the service is fixed or mobile. In addition to these dimensions of product differentiation, we observe in the market, and will continue to see, variation in pricing and terms of service, such as usage limitations or alternative pricing models.[63]

The Commission is trying to establish an auction to buy heterogeneous services.[64] As a result, it is unlikely that a reverse auction mechanism will result in significant savings.

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[58] Peter Cramton, *Spectrum Auction Design* 2 (Aug. 11, 2009); Schoenherr & Mabert, *supra* note 53, at 376; Dolpanya, *supra* note 18, at 8; Soudry, *supra* note 21, at 344, 366.
[59] Dolpanya, *supra* note 18, at 8; Bajari, *supra* note 26, at 377; Edward P. Moser, *E-Procurement—Successfully Using and Managing Reverse Auctions*, PHARMACEUTICAL TECH., Apr. 2002, at 100.
[60] Whitney Brown & Lana D. Ray, *Electronic Reverse Auctions in the Federal Government* 63-67 apx. B (2007), *available at* http://is.gd/gSj0S.
[61] Soudry, *supra* note 21, at 366.
[62] Melisande Cardona, et al., *Demand Estimation and Market Definition for Broadband Internet Services*, 35 J. REG. ECON. 70, 87 (2009); Mark Rodini, et al., *Going Mobile: Substitutability between Fixed and Mobile Access*, 27 TELECOMM. POL'Y 457, 458 (2003); James Alleman, et al., *Universal Service: A New Definition?*, 34 TELECOMM. POL'Y 86, 89 (2010).
[63] *DOJ Filing*, at 7.
[64] Lehman, *supra* note 48, at 5-6.

E. Reverse Auctions Can Compromise Product Quality

The quality-focused buyer is better off not using reverse auctions to purchase products.[65] To be sure, public buyers will try to safeguard quality standards through regulations and the threat of post-auction penalties, but those efforts are counterbalanced by the economic incentives of auction winners, who seek to bolster auction-eroded profits through a variety of tactics, including cost and quality reductions, that do not yield any savings for the buyer.[66] Such quality compromises can become endemic in regulated industries when "neither the regulator nor consumers are readily able to observe the level of service quality delivered by the regulated firm."[67]

Even without reverse auctions playing a role, dominant competitors in network industries are already inclined to compromise service quality. When a dominant network operator with an interconnection mandate can distinguish between high-value and low-value customers, as in broadband markets, two things tend to happen: the dominant network operator will (1) compromise the quality of service for low-value customers like those in high cost areas and (2) degrade the quality of interconnection with smaller network operators in an effort to induce switching and to raise operating costs for the smaller operator.[68] When service quality is observable and verifiable, a regulator can prevent service compromises by choosing a single operator and contracting with the selected operator to serve customers at a minimum quality

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[65] Steven L. Schooner & Christopher Yukins, *Emerging Policy and Practice Issues, in* YEAR IN REVIEW CONFERENCE BRIEFS COVERING 2004, 9-22 (citing Jeffrey K. Liker & Thomas Y. Choi, *Building Deep Supplier Relationships*, HARVARD BUS. REV. (Dec. 2004), at 104-106).

[66] *See* JAMES P. WOMACK, ET AL., THE MACHINE THAT CHANGED THE WORLD 140-146 (2007). *See also* Max Chafkin, *The Case Against Reverse Auctions*, INC. (May 1, 2007), *available at* http://www.inc.com/magazine/20070501/salesmarketing-pricing-case-against-reverse-auctions.html.

[67] David E. Sappington, *Regulating Service Quality: A Survey*, 27 J. REG. ECON. 123, 124 (2005).

[68] *See, e.g.*, Raymond Deneckere & Randolph McAfee, *Damaged Goods*, 5. J. ECON. & MNGT. STRATEGY 149 (1996); Sappington, *supra* note 67, at 128. Indeed, Congress passed the Act in part to control for this very problem in the telecommunications industry. *Id.* at 140.

standard.[69] But when service quality observations are imperfect, as in wireless and wireline telecommunications, consumers benefit more when multiple firms compete on service quality.[70] So, given that (a) reverse auctions tend to spur market consolidation, (b) consolidation removes competitive incentives to innovate and enhance product quality, and (c) the Commission has until recently largely abandoned service quality measurement as a "theoretical concern,"[71] especially with respect to the wireless industry, it simply does not make sense for the Commission to auction support.[72] As a sophisticated buyer, the Commission would instead be better served by bolstering product quality through efforts to improve competition.[73]

F. Reverse Auctions Heighten Administrative Burdens

Finally, reverse auctions require additional enforcement, especially when products are purchased from concentrated markets. Collusion and corruption often arise in public procurements both at home and abroad.[74] In India, irregularities in a 2008 spectrum auction recently led the Minister of Telecommunications to resign and have plunged the governing

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[69] Sappington, *supra* note 67, at 139.
[70] *See* Asher Wolinsky, *Regulation of Duopoly: Managed Competition v. Regulated Monopolies*, 6 J. ECON. & MGMT. STRATEGY 821 (1997).
[71] *Compare Service Quality Measurement, Customer Satisfaction, Infrastructure and Operation Data Gathering*, WC Docket No. 08-190, Memorandum Opinion & Order & Notice of Proposed Rulemaking, 23 FCC Rcd. 13647, 13652 (2008) [hereinafter *ARMIS Forbearance Order*], *with Consumer Information and Disclosure*, CG Docket No. 09-158; Notice of Inquiry, 24 FCC Rcd. 11380 (2009) [hereinafter *Consumer Information NOI*]. *See also* Philip J. Weiser, *Institutional Design, FCC Reform, and the Hidden Side of the Administrative State*, 61 ADMIN. L. REV. 675, 717 (2009) (noting that the *ARMIS Forbearance Order* "moved the FCC in the wrong direction.").
[72] William J. Baumol, *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Market Capitalism* (2002); *see also* William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 941 (1981) ("[T]he output of a competitive industry is greater than that of a monopolist[.]"); United States Government Accountability Office, *FCC Needs to Improve Oversight of Wireless Phone Service* 22-23 (Rep. No. GAO-10-34, Nov. 2009)("According to the FCC, the agency does not regulate…call quality, since the competitive marketplace addresses these issues, leading carriers to compete on service quality and proactively respond to any related concerns from consumers.") [hereinafter *GAO Service Quality Report*].
[73] Giampietro & Emiliani, *supra* note 20, at 81; Alejandro Manelli & Daniel Vincent, *Optimal Procurement Mechanisms*, 63 ECONOMETRICA 591, 591-620 (1995).
[74] Yvan Lengwiler & Elmar Wolfstetter, *Corruption in Procurement Auctions* in HANDBOOK OF PROCUREMENT 412 (2006) ("Collusion means that bidders coordinate their actions with the intention to increase the price. Corruption means that the person who runs the auction, the auctioneer, twists the auction rules in favor of some bidder(s)[.]"); Soudry, *supra* note 21, at 361 (noting that evidence of collusion in both public and private procurements is widespread, including in utility procurements.).

Congress Party into unprecedented crisis.[75] Despite overwhelming success in providing broadband to public schools, the e-rate program has been beset by multiple instances of collusion and fraud.[76] Similarly, spectrum auctions have been used by incumbents to allocate markets, freeze out smaller competitors, and otherwise game the system for competitive advantage.[77] During the Commission's most recent foray into support auctions, submissions to the Joint Board showed industry efforts to define auction rules in favor of specific technologies or carriers.[78] Such forms of collusion and corruption are likely to occur where, as here, the characteristics of an industry and its products facilitate such behaviors, especially when only a few participants compete in the auction.[79]

Bid rigging is more likely to occur in markets with a small number of competitors, little or no market entry, down market conditions, and a lack of product substitutes.[80] And when viewed at the local level, the telecommunications industry qualifies as just such a market.

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[75] Jim Yardley & Heather Timmons, *Telecom Scandal Plunges India into Political Crisis*, NY TIMES, Dec. 13, 2010, at A1.

[76] *See, e.g.*, Press Release, Federal Communications Commission, HP to Pay $16.25 Million to Settle DOJ-FCC E-Rate Fraud Investigation (Nov. 10, 2010); Press Release, Department of Justice, Local Businessman Sentenced To 5 Years In Prison For Fraud & Bribery Involving Federal "E-Rate" Funds (Dec. 22, 2008); Press Release, Department of Justice, Fresno, California, Electrical Contractor Pleads Guilty To Bid Rigging On Two E-Rate Funded School Technology Projects (June 18, 2008); Press Release, Department of Justice, Owner Of Kansas City Computer Service Companies And Family Member Indicted In Scheme To Defraud Federal E-Rate Program (Apr. 24, 2008); Press Release, Department of Justice, Two New Jersey Executives Agree To Plead Guilty In Nationwide Scheme To Defraud The Federal E-Rate Program(Apr. 23, 2008); Press Release, Department of Justice, Former Telecom Owner Indicted For Scheme To Defraud Federal E-Rate Program (Dec. 6, 2006); Press Release, Department of Justice, Justice Department Charges California Company In Probe Of Federal E-Rate Program In California And Michigan (Feb. 8, 2006); Press Release, Department of Justice, Six Corporations And Five Individuals Indicted In Connection With Schemes To Defraud The Federal E-Rate Program (Apr. 7, 2005); Press Release, Department of Justice, Wisconsin Case Yields Guilty Pleas on Charges to Defraud the Federal E-Rate Program (Oct. 22, 2004); Press Release, Department of Justice, Five Indicted In Connection With A Scheme To Defraud The Federal E-Rate Program (Apr. 5, 2004).

[77] Brooke A. Masters, *Gabelli Settles FCC Auction Charges*, WASH. POST, July 14, 2006, at D01, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2006/07/13/AR2006071300773.html; Gregory Rose, *Spectrum Auction Breakdown: How Incumbents Manipulate FCC Auction Rules to Block Broadband Competition* 1-2 (New Am. Found. Working Paper No. 18, 2007), http://www.newamerica.net/files/WorkingPaper18_FCCAuctionRules_Rose_FINAL.pdf.

[78] Lehman, *supra* note 48, at 5-6.

[79] OECD, GUIDELINES FOR FIGHTING BID-RIGGING IN PUBLIC PROCUREMENT 2 (2009), http://www.oecd.org/dataoecd/27/19/42851044.pdf; Soudry, *supra* note 21, at 362.

[80] *Id.* at 2-3; Roycroft, *supra* note 40, at 14.

Consumers in the low-density areas for which the Mobility Fund is intended enjoy less choice in mobile broadband providers than their urban counterparts.[81] But under the *Mobility Fund NPRM*, the Commission would actually reduce the number of potential competitors even further by restricting the auction to a subset of applicants with spectrum holdings capable of supporting 3G, increasing the risk of collusion even further.[82]

Given that the proposed regulations would only award funding to a single recipient,[83] the Commission risks elevating the potential for collusion in later auctions after unsuccessful auction competitors exit the market.[84] In light of the Commission's uneven record on enforcement, [85] as well as the Commission's own findings regarding broadband competition, designing a support auction that facilitates collusion in such a manner "breeds disrespect for the FCC's authority and undermines the agency's credibility."[86] Moreover, suggesting that auctions will *a priori* reduce enforcement burdens, as recently indicated by a Commission staffer,[87] wholly ignores the fraud and inefficiencies that have plagued prior auctions.[88]

[81] *14th CMRS Report* at 19 ("[O]nly 30 percent of the rural population is served by at least three broadband providers."). In addition, the two largest providers of mobile wireless services have 60 percent of subscribers and revenue, 67 percent of the spectrum in the 700 MHz band, and 91 percent of the spectrum in the cellular band. *Id.* at 6.
[82] *See Mobility Fund NPRM* at 4; OECD, supra note 79, at 5; *see also* NEUCHTERLEIN & WEISER, *supra* note 33, at 237 (noting that Nash's game theory, which underpins the Commission's auction processes, does not resolve the question of how to limit collusion among auction participants); *but see* Soudry, *supra* note 21, at 363 ("according to economic analysis, collusion is more likely to occur in a reverse English auction procedure than in a first-price auction. This fact should be considered carefully when conducting competitive bidding in industries with fewer numbers of potential bidders, or in cases of repeated bidding.").
[83] *Mobility Fund NPRM* at 8 ¶15.
[84] *See* Jap, *supra* note 44, at 3.
[85] Kathleen Q. Abernathy, *My View from the Doorstep of FCC Change*, 54 FED. COMM. L.J. 199, 203 (2002); Warren G. Lavey, *Responses by the Federal Communications Commission to WorldCom's Accounting Fraud*, 58 Fed. Comm. L.J. 613, 616 (2006).
[86] *Id.* at 214.
[87] Wu, *supra* note 26, at 2.
[88] Rose & Lloyd, *supra* note 39, at 1.

III. Support Auctions are not Permissible under the Constitution or the Act

For several reasons, support auctions are not permissible under the Constitution, the Act, or the Commission's existing regulations.[89]

First, by collecting USF contributions from all ETCs and awarding distributions to only a limited set of ETCs, support auctions would transform the Fund into an unconstitutional tax.[90] When an entity is required to pay a fee, that entity must derive some benefit reasonably related to that fee.[91] So if the Fund is capitalized through collected fees, then those collected fees must bear a reasonable relationship to the services received.[92] With support auctions, however, losing carriers would receive no benefit from the contributions they are required to submit under § 254(d), transforming the Fund into a tax.[93] Moreover, because support auctions would allow carriers to bid below the actual cost of providing service, the Commission would be levying charges that bear no reasonable relationship to the cost of services rendered. Again, such a construct would render the Mobility Fund and the CAF a revenue measure and thus an unconstitutional tax. Given the ambiguity of language in § 254, however, USF must be funded

[89] Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) ("[A regulatory] agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."); Qwest Corp. v. FCC, 258 F.3d 1191, 1198-99 (10th Cir. 2001) (citing *Olenhouse v. Commodity Credit Corp.*, 42 F.3d 1560, 1575 (10th Cir. 1994) (determining that the FCC failed to provide adequate justifications to prove rational decision making in calculating subsidy mechanism for promoting universal service in high cost areas) ("If the agency has failed to provide a reasoned explanation for its action, or if limitations in the administrative record make it impossible to conclude the action was the product of reasoned decision-making, the reviewing court may supplement the record or remand the case to the agency for further proceedings. It may not simply affirm.")).

[90] Ronald J. Krotoszynski, Jr., *Reconsidering the Nondelegation Doctrine: Universal Service, the Power to Tax, and the Ratification Doctrine*, 80 IND. L. J. 240, 271 (2005) (noting the judicial test for a constitutional delegation of the Origination Power).

[91] Nat'l Cable Tel. Ass'n v. FCC, 554 F.2d 1094, 1106 (D.C. Cir. 1976) ("If the 'fee' unreasonably exceeds the value of the specific charges for which it is charged it will be held invalid.").

[92] *Id.* at 1108 ("Whatever standard the Commission uses as a basis for its [fee] it should not have the potentiality in any substantial number of individual instances to produce fees that are not reasonably related to the cost of the services that benefit the individual recipients who are being charged."); *see also* Alenco Commc'ns, Inc. v. FCC, 201 F.3d 608, 616 (5th Cir. 2000) (noting that §214 (e)(1) requires that "all telecommunications carriers shall be eligible to receive universal service support.").

[93] *See* Krotoszynski, Jr., *supra* note 90, at 241.

and operated like a fee system to avoid constitutional issues.[94] Otherwise, the FCC will be allowed to indefinitely extend its jurisdiction and its programs in violation of the Origination Clause.[95]

Second, support auctions would be an inequitable and discriminatory contribution scheme that violates § 254(d).[96] Because § 254 imposes contribution obligations upon all ETCs, if the Commission distributes some amount of high-cost support to auction winners, then the proposed auctions will place losing bidders at a competitive disadvantage with respect to winning carriers.[97] To the extent a losing bidder continues to compete in the supported area, they will be forced to maintain their contributions to the Fund while receiving no support from the fund in that area. That outcome violates § 254(d).

Third, single-winner support auctions would violate the Commission's charge to encourage local competition. The Commission is required to use its implementing authority to encourage broadband deployment by removing barriers to investment, promoting local competition, and promoting access to information services in rural areas.[98] The Commission's implementing authority includes § 214 and § 254, which require a Fund that supports both local competition *and* universal service.[99] In other words, competition and universal service are "twin

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[94] *See* Fox Television Stations, Inc. v. FCC, 129 S. Ct. 1800, 1811 (2009).
[95] Krotoszynski, Jr., *supra* note 93, at 244.
[96] *See* AT&T Corp. v. Pub. Util. Comm'n of Tex., 373 F.3d 641, 646 (5th Cir. 2004) (*citing* 47 U.S.C. § 254(d)).
[97] *Id.* at 647.
[98] *See* Comcast Corp. v. FCC, 600 F.3d 642, 658 (D.C.Cir. 2010)(*citing* 47 U.S.C. § 1302(a)); 47 U.S.C. § 256(b)(2)(C).
[99] AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371 (1999); *Alenco Communs., Inc.*, 201 F.3d at 615; Tex. Office of Pub. Util. Counsel v. FCC, 183 F.3d 393, 406 (5th Cir. 1999) [hereinafter *TOPUC*]; *First USF Report and Order*, 12 FCC Rcd. 8776, 8780-81; Conference Report, Telecommunications Act of 1996, House of Representatives, 104th Congress, 2d Session, H.Rept. 104-458, at p. 1 (noting a desire "to accelerate rapidly private sector deployment of advanced services and information technologies and services to all Americans by opening all telecommunications markets to competition[.]"); Report of the Committee on Commerce, Science, and Transportation, Telecommunications Competition and Deregulation Act of 1995, 104th Congress, 1st Session, S. Rpt. 104-23, at p. 5 ("The legislation reforms the regulatory process to allow competition for local telephone service by cable, wireless, long distance, and satellite companies, and electric utilities, as well as other entities.").

pillars" of the Act.[100] What's more, USF can "neither unfairly advantage nor disadvantage **one provider** over another, and neither unfairly favor nor disfavor **one technology** over another."[101] Rather, the Fund must "treat all market participants equally…so that the market, and not local or federal regulators, determines who shall compete for and deliver services to customers."[102] A support auction would violate these directives because the resulting "[u]nequal federal funding could discourage competitive entry in high-cost areas and stifle a competitor's ability to provide service at rates competitive to those of the incumbent."[103]

The anti-competitive impact of reverse auctions would pose a particular burden for small businesses seeking to compete against larger incumbents. Congress recognized the challenges faced by smaller telecommunications carriers and directed the Commission to reduce entry barriers for entrepreneurs and small businesses by promoting policies that favor vigorous economic competition.[104] But, to compete, small businesses must have access to capital sources like the high-cost Fund, as access to capital constrains both firm entry and firm growth.[105] (Indeed, out of any factor known to affect economic development, capital has the largest direct

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[100] 141 Cong. Rec. S8460 (statement of Sen. Kerry); *see also* 141 CONG. REC. S17,847 (1995) (State of Sen. Dorgan) ("Some of us feel very strongly that we ought to pass a bill that promotes competition, that opens the marketplace to more competition, and, yes, eliminates some regulations where competition can replace regulations. But there are two premises that are troublesome with that point. One is, you do not have competition in many rural areas. Often you have a circumstance where you only have one interest willing to serve, and that service sometimes has to be required. The economics simply do not dictate service. So you cannot deal with that quite the same way; ergo, we have the question about universal service and the need to make sure that exists in the legislation.").

[101] *First USF Report & Order*, 12 FCC Rcd. 8776, ¶ 47 (emphasis supplied).

[102] *Alenco Communications, Inc*. 201 F. 3d at 616. Of course, much like defining spectrum rights or the process of auctioning them, designing obligations for recipients of high-cost support and auctioning those obligations is never neutral. Ellen P. Goodman, *Spectrum Auctions and the Public Interest*, 7 J. ON TELECOMM. & HIGH TECH. L. 343, 362-363 (2010) ("All spectrum auctions reflect a chain of decisions that, from beginning to end, incorporate regulatory values and priorities. At no point is this process value-free or driven purely by efficiency concerns. At every stage, the government makes decisions that will favor certain bidders over others and certain spectrum applications over others in what it claims is a vindication of the public interest.").

[103] *Federal-State Joint Board on Universal Service*, Ninth Report & Order & Eighteenth Order on Reconsideration, 14 FCC Rcd. 20432, 20480 (1999).

[104] 47 U.S.C. § 257.

[105] *See, e.g.*, Thorsten Beck & Asli Demirguc-Kunt, *Small & Medium-Size Enterprises: Access to Finance as a Growth Constraint*, 30 J. BANKING & FIN. 2931, 2935-2942 (2006).

effect on firm growth.)[106] By auctioning support, the Commission would eliminate a source of capital for small businesses and protect winning bidders from competition. Such a construct would violate §257, which requires the identification and elimination of "market entry barriers for entrepreneurs and other small businesses in the provision and ownership of telecommunications services and information services[.]"

Fourth, the proposed Mobility Fund would not support ongoing operating expenses. Under the Act, the Commission must provide support sufficient enough to allow rural consumers to access mobile wireless services that are reasonably comparable to those available to urban consumers.[107] The Commission defines "sufficient" support as "an affordable and sustainable amount of support that is adequate, but no greater than necessary, to achieve the goals of the universal service program."[108] If the Mobility Fund provides a one-time infusion of support for capital assets, but the cost of operating those assets exceeds the revenue from those assets, then the Mobility Fund will violate the sufficiency requirement in § 254 (b)(5).

Fifth, to safeguard the quality of service provided by winning bidders, support auctions would create a reporting regime that contradicts the Commission's earlier decisions and overlaps with other consumer protection mandates.[109] Specifically, the *Mobility Fund NPRM* proposes that winning bidders would be required to prove "that they have deployed a network covering the area and meeting minimum quality standards[,]" while the ongoing *Consumer Information NOI* seeks comment on certain service quality dimensions.[110] Imposing service quality reporting

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[106] Meghana Ayyagari, et al., *How Important Are Financing Constraints? The Role of Finance in the Business Environment*, 22 WORLD BANK ECON. REV. 483, 484 (2008).
[107] 47 U.S.C. § 254 (b)(3), (b)(5), (e).
[108] *High Cost Universal Serv. Support*, WC Docket No. 05-337, 25 FCC Rcd. 4072, 4074 (2010).
[109] *Compare ARMIS Forbearance Order*, 23 FCC Rcd. at 13652, *with Mobility Fund NPRM* at ¶ 44, *GAO Service Quality Report* at 29, *and* 47 U.S.C. § 332 (c)(3)(A).
[110] *Compare Mobility Fund NPRM* at ¶ 40, *with Consumer Information NOI*, 24 FCC Rcd. at 11390.

requirements on carriers is allowable under the Act, insofar as the Commission is empowered by Congress to require service quality reports from carriers.[111] But until recently, the FCC has approached such mandates with a "light touch."[112] In 2002, for example, the Commission eliminated a regulation that required cellular carriers to publish coverage maps, in part because of the level of competition in the marketplace.[113] Similarly, in the *ARMIS Forbearance Order*, the Commission abandoned service quality regulations that were designed to address two potential concerns: "first, that carriers might lower quality of service, instead of being more productive, in order to increase short term profits; and second, that carriers might not spend money on infrastructure development."[114] By imposing ongoing reporting requirements with respect to receipt of high-cost support, the Commission would in effect acknowledge (a) that competition no longer safeguards the quality of services provided in high-cost areas and (b) a that there is a renewed need for service quality regulation. What's more, requiring ongoing service quality reports of auction winners would undermine the competitive findings that originally allowed the Commission to stop imposing service quality regulations in the *ARMIS Forbearance Order*.

Finally, support auctions would violate § 254 by allowing for elevated prices in high-cost areas.[115] Section 254 requires that consumers must have access to advanced telecommunications and information services at rates reasonably comparable to those charged for similar services in urban areas. But as explained above, support auctions would provide winners with increased

[111] *See, e.g.*, 47 U.S.C. §§ 218, 219, 303(j), 403, 1302.
[112] *GAO Service Quality Report* at 23; *but see Consumer Information NOI*. The Commission has also acknowledged that Title II may limit its ability to collect and publish service quality information. *Consumer Information NOI*, 24 FCC Rcd. at 11399.
[113] *Amendment of Part 22 of the Commission's Rules to Modify or Eliminate Outdated Rules Affecting the Cellular Radiotelephone Service and Other Commercial Mobile Radio Services*, WT Docket No. 01-108, Second Report & Order, 17 FCC Rcd 18485, 18489, ¶ 8 (2002).
[114] *ARMIS Forbearance Order*, 23 FCC Rcd. at 13649.
[115] *See* Qwest Commc'ns Int'l. v. FCC, 398 F. 3d 1222, 1234 (2005).

market power.[116] Given that cost and income not only effect broadband adoption, but are in fact two of the primary barriers to broadband adoption in America,[117] then a distribution mechanism that facilitates increased prices in high-cost, low-income areas would undermine universal service.[118] To be sure, when formulating regulations for the Fund, "the FCC may exercise its discretion to balance the principles of [§ 254(b)] against one another when they conflict, but may not depart from them altogether to achieve some other goal."[119] But if § 254(i) requires affordable rates and § 332 prevents States from regulating CMRS rates, then the only rational, equitable policy lever short of allocating new spectrum or federal rate regulation is an equitable distribution of the Fund

Conclusion

As the Commission has concluded twice before, the use of reverse auction mechanisms to distribute USF presents a number of practical and legal problems for policymakers. Chief among them is the likelihood that an auction will recreate the very problem the 1996 Act intended to solve–the problem of dominant carriers in rural areas erecting insurmountable barriers to entry by virtue of their having all the customers and all the support.

In a single winner auction, the Commission will have to regulate rates, service quality, interconnection, and other terms in order to effectively create an "artificial marketplace." By

[116] *See* Landes & Posner, *supra* note 72, at 939.
[117] NTIA RESIDENTIAL BROADBAND REPORT at 17 (noting that expense is the primary barrier to adoption for 26% of those without a home internet connection); U.S. Government Accountability Office, *Telecommunications: National Broadband Plan Reflects The Experiences of Leading Countries, but Implementation will be Challenging* 16-18 (Report No. GAO-10-825, Sept. 2010) ("Cost—including a monthly broadband subscription price and the price of a computer or other device for accessing the Internet—is another key factor affecting broadband adoption rates."); Aaron Smith, Pew Internet & American Life Project, *Home Broadband 2010*, 10 (Aug. 11, 2010) (price is a barrier to adoption for 21% of users who don't have a home internet connection).
[118] Notably, under § 332 of the Act, states may not regulate rates charged by CMRS carriers.
[119] *See* Rural Cellular Ass'n v. FCC, 588 F.3d 1095, 1103 (2009); *Qwest Corp.*, 258 F.3d at 1200.

dictating a specific number of providers in an area, regulators merely succeed in precluding new entry and reducing, if not eliminating, the benefits of competition for rural citizens.

Additionally, deep-pocketed large carriers have shown little desire to provide high-quality wireless service in many high-cost areas. In an auction, these carriers will have an enormous incentive to drive support levels below cost so that carriers who want to serve rural America are either driven out, or forced to bid lower than the appropriate level needed to provide high-quality service.

The largest carriers have a significant incentive to win reverse auctions by bidding next to nothing, and then providing service at absolute bare-minimum levels with the smallest area of coverage possible to satisfy regulators, but to the detriment of consumers. The lack of support to competitors will also reestablish the barrier to entry that the 1996 Act tore down. Carriers like those represented by the undersigned, who have invested in their networks over the years, would not receive the support needed to maintain and upgrade networks in remote areas, causing cell sites to be decommissioned, and harming consumers who would lose service coverage.

The bottom line is this: targeting an efficient level of support to an area, and requiring all eligible carriers to offer service throughout the area is a better means of ensuring that citizens have a fair opportunity to select newcomers capable of offering better or less expensive services. Support to a high-cost area should be limited to the amount of support needed to efficiently provide consumers with high-quality broadband and mobile wireless services. In order to control costs within the Fund, and to address the problems posed by reverse auctions, the Commission should instead rely upon a forward-looking economic cost model to distribute support. After all, even if the FCC auctions support, the Commission will still have to model costs to set a reserve

price.[120] So rather than developing yet another forward-looking economic cost model for support auctions, the Commission should instead revise the HCPM to reflect "improvements in cost modeling that have occurred within the industry and outside of Commission proceedings over the last several years."[121] Any other result would ignore the wishes of Congress, which enshrined both competition *and* universal service in the Act.

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[120] *See CAF Notice*, 22 FCC Rcd. at 6666; James W. Stegeman, et al., *Proposal for a Competitive and Efficient Universal Service High-Cost Approach* 6 (2007) ("Whether one is considering forward looking economic costs, reverse auctions, or NECA accounting methods, a model of some sort forms the necessary background for funding."). For this reason, the *CAF Notice* seeks comments on using cost models to set reserve prices for a "market-based mechanism," while the *Mobility Fund NPRM* proposes to establish a "maximum amount" of support. *Compare CAF Notice*, 22 FCC Rcd. at 6667, *with Mobility Fund NPRM* at ¶ 66.
[121] *CAF Notice*, 22 FCC Rcd. at 6670.

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